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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

THE VANCOUVER CLINIC, INC.,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

Case No.

COMPLAINT FOR REFUND OF
OVERPAYMENTS OF FEDERAL
PAYROLL TAX

COMPLAINT

For its complaint Plaintiff, The Vancouver Clinic, Inc., by and through its undersigned counsel, alleges as follows:

NATURE OF THE CASE

1. Plaintiff is a professional service corporation, incorporated under the laws of the State of Washington.
2. The Defendant is the United States of America.
3. This is a suit arising under Section 7422 of the Internal Revenue Code (26 U.S.C.) and the laws of the Internal Revenue Code for the refund of payroll taxes and interest erroneously and illegally assessed against and collected from the Plaintiff by Defendant.

5. Plaintiff provides medical treatment in a variety of specialties at six separate locations in southwest Washington.

7. The tax periods subject to this dispute are the first, second, third and fourth quarters of each of the calendar years 2007, 2008 and 2009 (the “Tax Periods”).

9. The purpose of each of the Loan Agreements is to facilitate physician recruitment and retention.

11. During the Examination Plaintiff presented to Defendant all documents and information requested by Defendant, including copies of each of the Loan Agreements.

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1 13. During the Examination Plaintiff did not fail or refuse to present to
2 Respondent any documents or information requested by Respondent.

3 14. Defendant has in its possession copies of all of the Loan Agreements and has
4 actual knowledge of their contents.

5 15. The terms of each Loan Agreement were substantially similar, with the
6 exception of the amounts loaned by Plaintiff to the respective physicians.

7 16. Under the Loan Agreements, Plaintiff issued initial loans to each physician
8 within 30 days of the start of the physician's employment.

9 17. In addition, within 30 days of the physician's one-year anniversary of
10 employment, Plaintiff issued another loan to the physician, generally in the same amount as
11 the amount of the initial loan.

12 18. As used herein, the initial loan and the one-year anniversary loan described
13 above are collectively referred to as the "Loan."

14 19. Under each Loan Agreement, interest is accrued on the principal balance of
15 the Loan at the prime rate of Plaintiff's primary bank (for example, 3.25% as of
16 December 31, 2009).

17 20. Under each Loan Agreement, the borrowing physician was liable for the
18 entire balance of the principal and accrued interest, unless the Loan was forgiven pursuant to
19 the terms of the Loan Agreement.

20 21. Under the terms of each Loan Agreement, the Plaintiff would forgive the
21 principal and interest owed by a physician only if the physician remained an employee of the
22 Plaintiff for a period of at least three years.

23 22. Under the terms of each Loan Agreement, Plaintiff would forgive the Loan
24 based on a schedule contained in the Loan Agreement.
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1 23. The forgiveness schedule under each Loan Agreement provides that 25% of
2 the Loan would be forgiven at the end of both the third and fourth years of a physician's
3 employment and that the remaining 50% would be forgiven at the end of the fifth year of a
4 physician's employment.

5 24. Under the terms of each Loan Agreement, no debt is to be forgiven where:

- 6 a. A physician terminates his employment with the Plaintiff for any reason
7 besides death or disability;
8 b. The Plaintiff terminates a physician pursuant to certain terms contained
9 in the physician's employment agreement; or
10 c. A physician fails to comply with the terms of the Loan Agreement.

11 25. Under the terms of each Loan Agreement, a physician must repay any of the
12 loan balance that is not forgiven.

13 26. Under the terms of each Loan Agreement, the balance is due within 30 days
14 after the date the physician terminates his employment; the Plaintiff terminates the physician
15 pursuant to certain terms of the physician's employment agreement; or the physician fails to
16 comply with the terms of the Loan Agreement.

17 27. Under the terms of each Loan Agreement, Plaintiff has recourse to a
18 physician's personal assets to secure repayment of the Loan.

19 28. During the Examination Plaintiff presented to Defendant all documents and
20 information necessary to evidence and substantiate the manner in which Plaintiff treated the
21 Loans for financial reporting purposes and for tax purposes.

22 29. Defendant has in its possession copies of all of Plaintiff's documents and
23 information necessary to evidence and substantiate the manner in which Plaintiff treated the
24 Loans for financial reporting purposes and for tax purposes, and has actual knowledge of the
25 contents thereof.
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1 30. Defendant has in its possession the originals of Plaintiff's federal payroll tax
2 returns for the first, second, third and fourth quarters of the years 2007, 2008 and 2009,
3 respectively, and has actual knowledge of the contents thereof.

4 31. Defendant has in its possession the originals of Plaintiff's federal income tax
5 returns for the years 2007, 2008 and 2009, respectively, and has actual knowledge of the
6 contents thereof.

7 32. Plaintiff has consistently treated the funds transferred to the physicians under
8 the Loan Agreements as bona fide loans for financial reporting and tax purposes.

9 33. For financial reporting purposes, Plaintiff has reported the Loans as
10 "physician notes receivable" on its balance sheet, and has accrued the corresponding interest
11 income on its income statement.

12 34. Plaintiff has always treated the funds transferred to the physicians under the
13 Loan Agreements as notes receivable for federal income tax purposes, and has not deducted
14 the loaned amounts as compensation expense in the years the funds are disbursed, for income
15 tax purposes or otherwise.

16 35. Throughout the history of Plaintiff's use of Loan Agreements, whenever a
17 physician's balance was not forgiven, Plaintiff has consistently demanded and collected
18 repayment from each physician for the entire balance due.

19 36. During the tax year 2007, Plaintiff loaned to approximately 44 physicians the
20 aggregate sum of approximately \$663,500.

21 37. Of the \$663,500 loaned to physicians in 2007, approximately \$144,800 has
22 been repaid to Plaintiff, together with approximately \$18,790 of interest thereon.

23 38. Of the \$663,500 loaned to physicians in 2007, approximately \$465,000 has
24 been forgiven by Plaintiff, together with approximately \$86,418 of interest. All of the
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1 forgiven sums have been reported by Plaintiff to the Internal Revenue Service, as income to
2 the physicians, in the respective years in which the debt amounts were forgiven.

3 39. During the tax year 2008, Plaintiff loaned to approximately 35 physicians the
4 aggregate sum of approximately \$482,000.

5 40. Of the \$482,000 loaned to physicians in 2008, approximately \$119,000 has
6 been repaid to Plaintiff, together with approximately \$11,465 of interest thereon.

7 41. Of the \$482,000 loaned to physicians in 2008, approximately \$89,250 has
8 been forgiven by Plaintiff, together with approximately \$8,226 of interest. All of the
9 forgiven sums have been reported by Plaintiff to the Internal Revenue Service, as income to
10 the physicians, in the respective years in which the debt amounts were forgiven.

11 42. During the tax year 2009, Plaintiff loaned to approximately 34 physicians the
12 aggregate sum of approximately \$441,674.

13 43. Of the \$441,674 loaned to physicians in 2009, approximately \$14,800 has
14 been repaid to Plaintiff, together with approximately \$1,414 of interest thereon.

15 44. Of the \$441,674 loaned to physicians in 2009, none has been forgiven.

16 45. As of November 30, 2011, nine physicians who had terminated employment
17 with Plaintiff were contractually obligated to repay to Plaintiff sums loaned pursuant to Loan
18 Agreements.

19 46. As of November 30, 2011, six of the physicians described in paragraph 45
20 were making repayments to Plaintiff pursuant to agreed repayment schedules.

21 47. As of November 30, 2011, one of the physicians described in paragraph 45
22 was making repayments to Plaintiff pursuant to a revised payment schedule.

23 48. As of November 30, 2011, one of the physicians described in paragraph 45
24 was making repayments to a collection agency retained by Plaintiff to collect the debt.
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49. As of November 30, 2011, one of the physicians described in paragraph 45 was subject to collection of the debt to Plaintiff through a collection agency retained by Plaintiff, which was in second position to the Defendant's garnishments upon the same physician.

50. Plaintiff timely filed with the Internal Revenue Service Treasury Forms 941, "Employer's Quarterly Federal Tax Return," for each of the Tax Periods set forth below, and paid to Defendant, timely and in full, the tax reported in each of those returns.

| <u>Tax Period</u> | <u>Tax</u> |
|---------------------|-------------|
| First Quarter 2007 | \$3,660,564 |
| Second Quarter 2007 | \$3,853,917 |
| Third Quarter 2007 | \$3,573,508 |
| Fourth Quarter 2007 | \$4,144,658 |
| First Quarter 2008 | \$4,533,148 |
| Second Quarter 2008 | \$4,373,263 |
| Third Quarter 2008 | \$3,761,766 |
| Fourth Quarter 2008 | \$4,228,690 |
| First Quarter 2009 | \$4,736,408 |
| Second Quarter 2009 | \$4,826,461 |
| Third Quarter 2009 | \$4,497,151 |
| Fourth Quarter 2009 | \$4,769,812 |

51. As originally filed, Plaintiffs Forms 941 for each of the tax periods described in Paragraph 51 were true, accurate, correct and complete in all respects.

52. On or about January 10, 2011 the Defendant, through the Internal Revenue Service, assessed against the Plaintiff withholding and FICA taxes (Form 941 taxes), together with interest, as follows:

| <u>Tax Period</u> | <u>Tax</u> | <u>Interest</u> | <u>Total</u> |
|---------------------|------------|-----------------|--------------|
| First Quarter 2007 | \$55,380 | \$12,055 | \$67,435 |
| Second Quarter 2007 | \$55,380 | \$10,709 | \$66,089 |
| Third Quarter 2007 | \$55,380 | \$9,390 | \$64,770 |
| Fourth Quarter 2007 | \$55,380 | \$8,152 | \$63,532 |
| First Quarter 2008 | \$38,656 | \$4,969 | \$43,625 |
| Second Quarter 2008 | \$38,656 | \$4,353 | \$43,009 |
| Third Quarter 2008 | \$38,656 | \$3,779 | \$42,436 |
| Fourth Quarter 2008 | \$38,656 | \$3,179 | \$41,835 |
| First Quarter 2009 | \$38,118 | \$2,669 | \$40,787 |
| Second Quarter 2009 | \$38,118 | \$2,259 | \$40,377 |
| Third Quarter 2009 | \$38,118 | \$1,854 | \$39,972 |
| Fourth Quarter 2009 | \$38,118 | \$1,453 | \$39,571 |
| Total | | | \$593,438 |

53. On or about January 25, 2011 Plaintiff paid the withholding and FICA tax assessments (Form 941) together with the interest attributable thereto, for each of the tax periods listed above, in the total amount of \$593,438.

54. The assessment and collection of the additional tax stated above, and of interest thereon for each of the quarters of calendar years 2007, 2008 and 2009, were erroneous and illegal.

55. On or about June 15, 2011 Plaintiff filed with the District Director of Internal Revenue, Portland, Oregon claims for refund of the tax overpayments paid by it, in the following sums:

| <u>Tax Period</u> | <u>Refund Claimed</u> |
|--------------------|-----------------------|
| First Quarter 2007 | \$67,435 |

| | | |
|----|---------------------|----------|
| 1 | Second Quarter 2007 | \$66,089 |
| 2 | Third Quarter 2007 | \$64,770 |
| 3 | Fourth Quarter 2007 | \$63,532 |
| 4 | First Quarter 2008 | \$43,625 |
| 5 | Second Quarter 2008 | \$43,009 |
| 6 | Third Quarter 2008 | \$42,436 |
| 7 | Fourth Quarter 2008 | \$41,835 |
| 8 | First Quarter 2009 | \$40,787 |
| 9 | Second Quarter 2009 | \$40,377 |
| 10 | Third Quarter 2009 | \$39,972 |
| 11 | Fourth Quarter 2009 | \$39,571 |

12 True copies of Plaintiff's Claims for Refund are attached hereto as Exhibit A.

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14 56. On November 16, 2011 Defendant, through the Director of the Ogden, Utah,
15 Service Center of the Internal Revenue Service, mailed to Plaintiff Notices of Disallowance
16 of each of its Claims for Refund of tax for each of the calendar quarters of each of the tax
17 years 2007, 2008 and 2009. Copies of each of the Notices of Disallowance are attached
18 hereto as Exhibit B.

19 57. As grounds for recovery, Plaintiff incorporates herein by reference the
20 averments contained in its Claims for Refund, Exhibit A, hereto.

21 58. As additional grounds for recovery, Plaintiff alleges that:

- 22 a. At all times relevant hereto, the transactions evidenced by the Loan
23 Agreements were bona fide loans between Plaintiff as lender and the
24 respective physicians as borrowers for financial and federal income tax
25 purposes.
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- b. Each Loan Agreement entered into by Plaintiff and a physician formed a personal and fixed liability of the physician, evidencing a valid indebtedness for financial and federal income tax purposes.
- c. None of the sums advanced under any of the Loan Agreements were compensation income to any physician.
- d. None of the sums advanced to the physicians under the Loan Agreements by Plaintiff constitute "wages." 26 USC § 3401.
- e. No portion of any debt cancelled by Plaintiff under any of the Loan Agreements constitutes "wages." 26 USC § 3401.
- f. No payroll tax is due on any of the sums advanced by Plaintiff under the Loan Agreements; nor upon the cancellation of any indebtedness due under any of the Loan Agreements.

59. Plaintiff has overpaid its Form 941 tax and interest for the respective tax periods described in Paragraph 55 of this Complaint in the sums described in Paragraph 55 of this Complaint.

60. Plaintiff is entitled to recover from Defendant the sum of \$593,438, plus interest thereon, no part of which has been repaid to Plaintiff.

61. Plaintiff is the sole owner of its Claims against Defendant and has made no assignment of any of said Claims.

62. The disallowances of Plaintiff's Claims for Refund by Defendant were not "substantially justified" within the meaning of 26 U.S.C. § 7430.

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PRAYER FOR RELIEF

63. WHEREFORE, Plaintiff prays for judgment against Defendant in the total amount of \$593,438, together with attorney fees, costs and interest as provided by law, and for such other and further relief as the Court may deem appropriate.

Dated this 9th day of January, 2012.

SCHWABE, WILLIAMSON & WYATT, P.C.

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